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SUBJECT: DJIBOUTI: 2008 INVESTMENT CLIMATE STATEMENT

REF: STATE 158802

¶1. SUMMARY: Foreign direct investment in Djibouti in 2007 is five times as large as it was in 2003. Djibouti's economy is service-based, with the country's seaport accounting for the bulk of economic activity. Almost all food and many other goods are imported from Ethiopia, the Arabian Gulf, or France. The services and commercial sectors account for more than 80 percent of GNP. Dubai World Group, Djibouti's main private investor, is active in various sectors including the port, tourism, customs and aviation. Djibouti is also experiencing a surge in the establishment of foreign commercial banks, predominantly from the Middle East, attracted by opportunities that could result from Dubai-based investments in Djibouti. Telecommunications are reliable, but expensive. Djibouti offers significant incentives to private-sector individuals and corporate investors, but obstacles to foreign investment include a small domestic market, and high labor and energy costs. END SUMMARY.

Openness to Foreign Investment

¶2. The Government of Djibouti (GODJ) recognizes the crucial need for foreign investment for the economic development of the country. Djibouti's assets include a strategic geographic location, an open trade regime, a stable currency, substantial tax breaks and other incentives. Potential areas of investment include:
-- Djibouti's port: the Doraleh fuel pier was dedicated in February 2006, and the construction of Doraleh container terminal started in November 2006, to be followed by a new free zone and supporting desalinization and power plants;
-- tourism: a large resort hotel complex managed by the Kempinski Hotel Group opened in October 2006;
-- manufacturing and fishing sectors. President Ismail Omar Guelleh has placed privatization, economic reform, and increased foreign investment as top priorities for his government. The president has pledged to seek the help of the international private sector to develop the country's infrastructure.

¶3. Djibouti does not have laws that would discourage incoming foreign investment. In principle there is no screening of investment or other discriminatory mechanisms. Certain sectors, most notably public utilities, are state-owned and are not currently open to investors. Dubai World Group currently manages the Port of Djibouti (since 2000), Djibouti International Airport (since 2002), and Djibouti Customs (since 2005). Istithmar World Aviation (IWA), a Dubai World company, is partnering with Daallo Airlines and the GODJ to restart the defunct Djibouti national air carrier in 2008.

¶4. The Ethiopia-Djibouti Railway Company cancelled the management contract signed with the South African company COMAZAR in 2006 because of COMAZAR's inability to provide solid financial guarantees. Al-Ghanem Group from Kuwait is expected to take over the private management contract.

¶5. In April 2004, the GODJ also conceded its fishing port to a private firm, Djibouti Maritime Management Investment (DMMI). In 2006, DMMI contracted a French firm, Oceanic Development, for the fishing port management. The GODJ is currently building a fish laboratory and a fish processing factory, which are expected to become operational in 2008.

¶6. Created in 2001, the National Investment Promotion Agency (NIPA) promotes private-sector investment, facilitates investment operations, and works to modernize the country's regulatory framework. The NIPA has been mandated to encourage and facilitate foreign investment by assisting with all administrative procedures. Its ultimate goal is to serve as a one-stop shopping center for investors. NIPA identifies fishing, banking, insurance, tourism, and manufacturing as priority sectors for investment.

¶7. In 2004, the Ministry of Finance reduced taxes on some products to encourage business sector growth. Automobile spare parts and recording or image producing electronic devices are subject to 8 per cent taxes (instead of 33 per cent), while taxes on electrical, plumbing, or sanitary material decreased from 33 to 20 per cent. Heavy construction engines and raw cloth are now subject to 8 per cent tax, instead of the previous 20 per cent. These tax reforms are meant to promote growth of the construction sector, transportation, and textile industry.

¶8. The most important direct foreign investment in Djibouti is the Port of Doraleh, located just west of the current seaport. The Doraleh Project will include when finished an oil terminal, a container terminal, and an industrial and commercial free zone financed by Emirates National Oil Company (ENOC) and Dubai Ports World (DPWorld). The first phase of the project, a modern oil terminal, was completed in August 2005 and dedicated in February
¶2006. The new duty free zone is now operational and,in November 2006, President Guelleh laid the cornerstone of the new Container Terminal of Doraleh Port. That 340 million dollar project is expected to be completed by mid-2009 and, when finished, that deep draft port will handle sixth generation container ships and serve as both the principle port for Ethiopian commerce and a transshipment hub.

¶9. Djibouti belongs to a number of regional integration groups and actively promotes the seven-member Inter-Governmental Authority on Development (IGAD). It is also part of the Common Market for Eastern and Southern Africa (COMESA), which groups 19 countries into a common market of more than USD 300 million. Djibouti successfully hosted the COMESA Summit in November 2006. Djibouti is eligible to benefit from the African Growth and Opportunity Act (AGOA), and is also a member of the World Trade Organization (WTO). In addition, Djibouti is among the 34 African least developed countries that have the option of entering the European Union Generalized System of Preferences.

Conversion and Transfer Policies

¶10. Djibouti has no foreign-exchange restrictions. There are no limitations on converting or transferring funds, or on the inflow and outflow of cash. The Djibouti franc, which has been pegged to the U.S. dollar since 1949, is stable. The fixed exchange rate is 177.71 Djibouti francs to the dollar.

Expropriation and Compensation

¶11. Djibouti's Investment Code stipulates "no partial or total, temporary or permanent expropriation will take place without equitable compensation for the damages suffered". The Embassy is not aware of any recent act of expropriation or compensation related to foreign companies. Given the government policy of promoting private investment, none are expected either. In December 2007, Djibouti and France signed a bilateral agreement on the promotion and protection of investment in each other's country, which, inter alia, extends legal protections to French investments in Djibouti.

Dispute Settlement

¶12. Djibouti's legal system is based on French law, and consists of three courts: a Court of First Instance, presided over by a single judge; a Court of Appeals, with three judges; and the Supreme Court. The Government has increased funding for the judiciary and recognized the need to increase the transparency and efficiency of the judicial process. International lawyers practicing in Djibouti have reported effective application of maritime and other commercial laws, but some foreign companies operating here complained, in the past, that court deliberations were biased or delayed.

¶13. Judgments by foreign courts are in principle accepted by Djiboutian courts. According to the Ministry of Justice, Djibouti is a member of the International Center for the Settlement of Investment Disputes, because any international agreement signed by France before Djibouti gained independence in 1977 is automatically binding in Djibouti. The Chamber of Commerce of Djibouti is planning to set up a Regional Mediation Center, designed to settle commercial disputes in a timely and transparent manner.

Performance Requirements/Incentives

¶14. Performance requirements are not a pre-condition for establishing, maintaining, or expanding foreign direct investments. Incentives do, however, increase with the size of the investment and the number of jobs created. Tax benefits and incentives fall under two categories detailed in the investment code. Investments greater than USD 280,000 that create a number of permanent jobs may be

exempted from license and registration fees, property taxes, taxes on industrial and commercial profits, and taxes on the profits of corporate entities. Imported raw materials used in manufacturing are exempted from the internal consumption tax. These exemptions apply for up to a maximum of ten years after production commences. Investment matters fall under the jurisdiction of the national investment board, which approves all investments.

¶15. Djibouti offers significant incentives to private-sector individuals and corporate investors. One U.S. firm that recently established a branch in the Free Zone hailed the speed and efficiency of the process. Establishing a local company outside the Free Zone is, reportedly, significantly more time consuming. The Djiboutian investment code guarantees investors the right to freely import all goods, equipment, products, or material necessary for their investments; display products and services; determine and run marketing policy and production; choose customers and suppliers; and set prices.
Foreign investors are also free to determine their own hiring and firing policy as long as it remains within the structure of the labor code.

¶16. The new Labor Code, which is not yet implemented, is expected to provide more confidence to potential investors. It contains the latest international recommendations and conventions on issues such as the worst forms of child labor, minimum age of working, protection for maternity, and measures against work place discrimination.

Right to Private Ownership and Establishment

¶17. Djiboutian laws guarantee rights for foreign and domestic private entities to establish and own business enterprises, and to engage in all forms of remunerative activity. Legally established private- sector companies have the same access to markets, land ownership, credit, and other business facilities, as do public enterprises. Although restrictions on private enterprises are minimal, competitive equality in regard to public enterprises, namely public utilities, remains limited.

Protection of Property Rights

¶18. There are sales of pirated trademarked products, especially in the informal market. A large share of trade with several countries is also done informally. Djibouti's legal system, inherited from the French, officially protects the acquisition and disposition of all property rights and safeguards intellectual property, patents, copyrights, trademarks, trade secrets, etc. In addition, Djibouti ratified the World Intellectual Property Organization (WIPO) convention, the Paris Convention on the Protection of Industrial Rights, and the Bern Convention on the Protection of Literature and Art Works. In July 2006, Djibouti passed a law (Law 154) enforcing the protection of copyrights. In 2006, Djibouti drafted a law on the protection of other intellectual property rights in close collaboration with the WIPO. This draft is currently under review by the Council of Ministers. So far, however, protection of intellectual property rights has not been strictly enforced.

Transparency of the Regulatory System

¶19. Djibouti's Port, Free Zone, Airport, and customs service are now managed by Dubai Ports World. With port and related activities accounting for much of the countries formal economy, the effect on the whole economy has been substantial. Port and customs revenues have increased significantly and shippers note striking improvement in transparency and efficiency of those operations. There are ongoing efforts to foster similar transparency in the rest of the economy, but bureaucratic obstacles and delays are often a problem.

Efficient Capital Markets and Portfolio Investment

¶20. Two large French commercial banks, Indosuez Bank (BIS) and Bank for Commerce and Industry (BCI), dominated the banking system for years, but now face competition from several new international banks. The French banks still account for most deposits. In the

past, their exposure to the economy has been limited mostly to short-term (trade) financing and lending. Credit is allocated on market terms, and foreign companies do not face discrimination in obtaining it. However, generally only well-established businesses obtain bank credit, as the cost of credit is high. Both banks have offered only a limited array of financial instruments: letters of credit, money transfer, and short and long-term loans.

¶21. Two new banks opened in 2006: the International Commercial Bank, a Malaysian firm recently listed in London, and the Saba Islamic Bank of Yemen. A third new bank, the "Bank of Deposits and Credits of Djibouti", a bank backed by Swiss capital, was inaugurated in December 2007. The Central Bank has approved the establishment of two additional banks, which are expected to start in 2008. In addition, other foreign banks have voiced interest in opening outlets in Djibouti. Propelled by increased competition and new loan products, including Djibouti's first long-term home mortgages, there has been a 20 per cent rise in the volume of loans made in ¶2007.

Political Violence

¶22. In 2007, there were no reports of political violence, but several protests over electricity shortages and water shortages led to confrontations between police and protesters. There were no deaths or reports of serious injuries as the result of such protests. There were claims of official impunity, arbitrary arrest and detention, and interference with privacy rights. Enforcement of libel laws had a chilling effect on press freedom, and there were restrictions on freedom of assembly and association. Despite legal guarantees, there were also restrictions on union activities and leaders.

Corruption

¶23. Corruption exists in Djibouti and sometimes becomes an obstacle to investment and business development. Recent major foreign investors have reported that they have operated free of government interference or corruption and the GODJ has pledged to protect as well as welcome new direct investment. However, there have been reports in the past of government officials applying pressure on smaller investors to become their "partners" or to obtain sub-contracts. Despite a substantial improvement in Customs transparency under Dubai World's management, there are still reports of business owners attempting to bribe officials to evade import taxes. There are also allegations that corruption in the judicial system continues to fuel uncertainty and mistrust among some local and foreign investors. Two magistrates were dismissed this year as the result of an investigation into judicial misconduct.

¶24. However, prosecution and punishment for corruption has been rare. The Chamber of Accounts and Fiscal Discipline (CAFD) has the authority to verify and audit all public establishments for transparency and accountability and implement necessary legal sanctions. The CAFD has reported on cases of lack of transparency and accountability in governmental agencies.

¶25. The State General Inspection (SGI), another government institution, complements the work of the CAFD by ensuring that human and material resources in the public sector are properly utilized. In its first report published in 2007, the SGI highlighted the necessity for a strategy to improve accountability and quality management, and urged strict enforcement of existing anti-corruption rules and regulations.

Bilateral Investment Agreements

¶26. Djibouti has several bilateral investment agreements. In 2007, it concluded a mutual investment treaty with France and also has accords with Ethiopia and Yemen, as well as Egypt, Malaysia, and India. Other treaties include: the Partnership Agreement between the Members of the African, Caribbean and Pacific Group of States (ACP); the Agreement for the Promotion, Protection and Guarantee of Investment Among Member States of the Organization of Islamic Conference; Articles of Agreement of the Islamic Corporation for the Insurance of Investment and Export Credit; and the Unified Agreement for the Investment of Arab Capital in the Arab States.

OPIC and other Investment Insurance Programs

¶27. Djibouti is eligible for Overseas Private Investment Corporation (OPIC) programs. OPIC offers up to USD 400 million in combined financial and political risk insurance to eligible U.S. investors. Also, Djibouti joined the Multilateral Investment Guarantee Agency (MIGA) in January 2007. MIGA has issued its first guarantees to Djibouti for the port of Doraleh.

Labor

¶28. A 2000 law makes attending school compulsory until the age of sixteen. Gross enrollment rates have risen from approximately 38 per cent in 1998 to approximately 66 per cent in 2007. The scarcity of vocational or professional training facilities has restricted the creation of a pool of skilled labor. The GODJ and the Port of Djibouti remain the nation's main employers, although there is growing private sector employment as well as jobs created by French and American military forces present in Djibouti.

¶29. By law, all employers are obligated to provide social security to their employees. The "Caisse National des Retraites" handles the social security of government workers with long-term contracts (fonctionnaires), and the "Organisme de Protection Sociale" deals with the private sector and government employees with short-term contracts (conventionnes). In 2007, these two agencies merged to form the "Conseil National de Securite Sociale". Wages in Djibouti are relatively high, compared to other countries in the region. This reflects influence from historically high French pay scales, paid before independence in 1977, and the high cost of living. One factor affecting employee performance and income is that the majority of Djiboutian men spend a significant percentage of their income on khat, a drug legal in the region. Increasingly, employers are forbidding their workers to use khat, but its use remains the norm in most sectors of the economy.

¶30. The Labor Code allows for employees to form labor unions. It also provides guidelines on wages, overtime pay, annual leave, sick leave, work schedules and holidays. A new Labor Code was approved by the Parliament in December 2005; however it is widely criticized by labor unions, who have asserted that it gives more rights to employers at the expense of workers. Two large labor unions exist in Djibouti, but only the Djiboutian Workers Union (UDT) is recognized by international organizations. The GODJ, which has the mandate to act as a mediator between the unions and the employers, regularly interferes with the internal affairs of labor unions.

Foreign Trade Zones/Free Ports

¶31. In 1995 the entire country of Djibouti was designated a free-export processing zone. Any company working exclusively for export in the industrial sector is eligible for designation as an Export Processing Company (EPC). The 17-hectare Djibouti Free Zone (DFZ) has been operational since 2004. It has the capacity to house up to 100 companies. In 2007, use of the Djibouti Free Zone approached full capacity. An expanded free zone is planned as part of the Doraleh project.

¶32. Djibouti's international airport, managed by DP World, is also planning to establish a free zone within its premises to complement the Doraleh Free zone. In addition, Dubai Customs World signed an agreement with Djibouti in July 2007 to establish and an automobile and heavy equipment free zone to meet the increasing demand for transport-related services in Djibouti. Using leased space, that vehicle zone is now in operation.

Foreign Direct Investment Statistics

¶33. The main source of Foreign Direct Investment (FDI) remains the Port of Doraleh project. Other FDIs include the construction of a five-star international hotel, funded by Dubai, which opened in November 2006.

¶34. The following data on annual FDI, from Djibouti's Central Bank, shows that FDI in 2007 was five times the amount in 2003 (USD million):

2003: 38.54
2004: 22.54
2005: 59.04
2006: 163.60
2007: 193.00

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